

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE MBIZANA LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Mbizana Local Municipality set out on pages XXX to XXX, which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (DORA), as well as such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my adverse audit opinion.

Basis for adverse opinion

Property, plant and equipment

6. Assets identified from the floor could not be traced to the fixed asset register of the municipality; as a result, property, plant and equipment is understated by R3,3 million.
7. The municipality was unable to provide sufficient appropriate audit evidence relating to the non-infrastructure assets additions amounting to R9,2 million that are included under property, plant and equipment in note 8 to the financial statements. I was unable to confirm the assets additions by alternative means. Consequently I was unable to determine whether any further adjustments were necessary to the amount disclosed in the financial statements.

8. In addition, the municipality could not provide supporting documents for a difference of R3,3 million between the fixed asset register and the property, plant and equipment balance disclosed in note 8. Consequently, I was unable to obtain sufficient appropriate audit evidence regarding the difference.

Cash flow statement

9. The municipality did not adhere to paragraph 19 of GRAP 2, which requires cash flows from operating activities to be reported using the direct method and disclosure of major classes of gross cash receipts and gross cash payments. The receipts from the sale of goods and services did not include any changes to the operating receivables, while the payments to suppliers and employees did not include any changes to operating payables or inventories. The effect of this is that cash flows from operating activities are overstated by R9,4 million.

Grants and subsidies paid

10. The municipality did not disclose grants and subsidies paid in terms of its function, as required by paragraph 100 of GRAP 1. Consequently, expenditure of R13,5 million as disclosed in note 24 to the financial statements has been incorrectly classified.

Consumer debtors

11. As the municipality did not adequately assess the provision for debt impairment on certain debtors, debtors were not adequately provided for. Consequently, the provision for debt impairment disclosed in note 3 to the financial statements is understated by R3,7 million. The debt impairment expense has been understated by the same amount.

Service charges

12. The municipality omitted and/or incorrectly recorded meter readings in the financial year. Consequently, service charges as disclosed in note 16 to the financial statements are understated by R3,4 million, while consumer debtors are understated by the same amount.

Distribution losses

13. The municipality incorrectly cast distribution losses (note 42), disclosing the loss as 55 303 364 units instead of 5 530 364 units. The effect of this error using the average per unit charge for the year is that distribution losses are overstated by R33,4 million.

General expenses

14. The municipality was unable to provide sufficient appropriate audit evidence relating to general expenditure incurred during the year. I was unable to confirm transactions expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments to general expenditure amounting to R27,3 million were necessary.

Payables from exchange transactions

15. The municipality was unable to provide sufficient appropriate audit evidence for an amount of R5,3 million included in note 11 to the financial statements. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments relating to payables from exchange transactions in the financial statements were necessary.

Prior period error

16. The prior period errors as disclosed in note 33 to the financial statements do not agree to the adjustments passed in the financial statements nor to the balances and transactions presented on the face to the financial statements. Management was unable to provide sufficient appropriate audit evidence relating to the variances identified. I was unable to confirm the restatement by alternative means. Consequently, I was unable to determine whether any adjustments to the corresponding figure were necessary.

Disclosure

17. Management did not adhere to the requirements of the reporting framework set out in Directive 5 on determining the GRAP reporting framework, as required by section 122(3) of the MFMA. For example, management failed to provide a comparison between actual figures and the budget as required by paragraph 12 of GRAP 1; management failed to comply with the disclosure requirements of GRAP 3 relating to the correction of prior period errors (refer to note 34) by not fully disclosing the reason for the error; and management failed to comply with the disclosure requirement of IFRS 7 by not fully disclosing all risks associated with the financial instruments disclosed.

Corresponding figures

18. During the 2010-11 year, I was unable to obtain sufficient appropriate audit evidence for the following figures:

- Property, plant and equipment – R10,7 million
- Payables from exchange transactions – R5,5 million
- Other receivables from non-exchange transactions – R3,9 million
- Value added tax receivable – R4,3 million
- Consumer debtors – R7,4 million
- Accumulated surplus – R4,5 million
- Irregular expenditure – R4,6 million
- Commitments – R3,5 million

19. I was unable to obtain sufficient appropriate audit evidence for the above by alternative means. Consequently, I was unable to determine whether any adjustments to these amounts and the accumulated surplus were necessary. My audit opinion on the financial statements for the 2010-11 period was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of these matters on the comparability of the current period's figures.

Aggregation of immaterial uncorrected misstatements

20. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position and the statement of financial performance:

Statement of financial position

- Property, plant and equipment in the statement of financial position and note 7 are understated by - R2,9 million
- Current liabilities are overstated by - R4.98 million
- Investment property is overstated by - R1,4 million
- Accumulated surplus is overstated by - R502 031

Statement of financial performance

- Revenue from exchange transactions is overstated by - R1.37 million
- Revenue from non-exchange transactions is understated by - R1.36 million
- Depreciation is understated - R780 922.
- General expenses are overstated by - R1.03 million.
- Employee costs is overstated by R505 783 - (2011: R707 252)

21. In addition, I was unable to obtain sufficient appropriate audit evidence and was unable to confirm or verify the following elements by alternative means:

Statement of financial position

- Current assets reflected at - R2.38 million
- Current liabilities reflected at - R348 810

Statement of financial performance

- Revenue from exchange transactions reflected as - (2011: R436 613)
- Revenue from non-exchange transactions reflected as - (2011: R440 316)
- Government grants and subsidies reflected as - (2011: R927 824)
- General expenses reflected as - R159 472 (2011: R 892 519)

22. As a result, I was unable to determine whether any adjustments to these elements were necessary.

Adverse opinion

23. In my opinion, because of the significance of the matters described in the basis for adverse opinion paragraphs, the financial statements do not present fairly the financial position of the Mbizana Local Municipality as at 30 June 2012 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

24. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Material losses

25. As disclosed in note 41 to the financial statements, the municipality suffered significant electricity losses totalling 5,5 million units during the year under review. Based on the average cost per unit of electricity, this loss totals R3,7 million.

Material underspending of the budget

26. The municipality materially underspent its capital expenditure budget and operational expenditure budget during the 2011-12 financial year. At the date of this report, the underspending amounted to R14,1 million and R6,3 million, respectively, and no satisfactory explanation was provided. This underspending had a negative impact on service delivery by the municipality.

Budget versus actual results not disclosed

27. The municipality did not disclose its budget versus actual performance in appendix A to the financial statements as noted in the index to the annual financial statements.

Other matter

28. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Material inconsistencies in other information included in the annual report

29. The municipality had not prepared the draft annual report by the reporting date and as such I was unable to verify the accuracy of the information disclosed in the annual report.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

30. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

31. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages XXX to XXX of the annual report.
32. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development priorities. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
33. The reliability of the information in respect of the selected development priorities is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
34. The material findings are as follows:

Usefulness of information

Performance targets not specific

35. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 89% of the targets relevant to the planning and infrastructure programme were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was aware of the requirements of the FMPPI but had not received the necessary training to enable application of the principles.

Performance targets not measurable

36. The FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 61% of the targets relevant to the planning and infrastructure programme. This was due to the fact that management was aware of the requirements of the FMPPI but had not received the necessary training to enable application of the principles.

Performance indicators not well defined

37. The FMPPI requires that indicators and measures should have clear, unambiguous data definitions so that data can be collected consistently and is easy to understand and use. A total of 58% of the indicators relevant to the planning and infrastructure programme were not well defined in that clear, unambiguous data definitions were not available to

allow for data to be collected consistently. This was due to the fact that management was aware of the requirements of the FMPPI but had not received the necessary training to enable application of the principles.

Performance indicators not verifiable

38. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 63% of the indicators or measures relevant to the planning and infrastructure programme were not verifiable in that valid processes and systems that produced the information on actual performance did not exist. This was due to the fact that management was aware of the requirements of the FMPPI but had not received the necessary training to enable application of the principles.

Measures taken to improve performance not disclosed

39. Improvement measures in the annual performance report for a total of 68% of the planned targets not achieved were not disclosed, as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA). This was due to inadequate internal policies and procedures over the processes pertaining to the reporting of performance information.

Measures taken to improve performance not supported by sufficient appropriate evidence

40. Section 46 of the MSA requires the disclosure of measures taken to improve performance in the annual performance report where planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for all of the measures taken to improve performance as disclosed in the annual performance report. The municipality's records did not permit the application of alternative audit procedures. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the validity, accuracy and completeness of the measures taken to improve performance.

Reported objectives not consistent with planned objectives

41. Section 41(c) of the MSA requires that the integrated development plan should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 56% of the reported objectives were not consistent with the objectives as per the approved integrated development plan. This was due to a lack of review of performance information by management.

Reported indicators not consistent with planned indicators

42. Section 41(c) of the MSA requires that the integrated development plan should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 83% of the reported indicators were not consistent with the indicators as per the approved integrated development plan. This was due to a lack of review of performance information by management.

Reported targets not consistent with planned indicators

43. Section 41(c) of the MSA requires that the integrated development plan should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 86% of the reported targets were not consistent with the targets as per the approved integrated development plan. This was due to a lack of review of performance information by management.

Reliability of information

44. The FMPPI requires that processes and systems that produce the indicator should be verifiable. A total of 55% of the actual reported performance relevant to the selected

objectives was not valid when compared to the evidence provided. This was due to a lack of monitoring, review and standard operating procedures for the recording of actual achievements by senior management.

Additional matter

45. I draw attention to the matter below. This matter does not have an impact on the audit findings on predetermined objectives reported above.

Achievement of planned targets

46. Of the total number of planned targets, only 34 were achieved during the year under review. This means that 42% of the total planned targets were not achieved during the year under review. This was as a result of the institution not considering relevant systems and evidential requirements during the annual strategic planning process.

Compliance with laws and regulations

47. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA are as follows:

Annual financial statements, performance report and annual report

48. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and/or the supporting records could not be provided subsequently, which resulted in the financial statements receiving an adverse audit opinion.
49. The accounting officer of the municipality did not by 25 January assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72(1)(a)(ii) of the MFMA.
50. The annual performance report did not contain a comparison of the performance of the municipality and of each external service provider with development priorities, objectives and performance indicators set out in its integrated development plan, as required by section 46 of the MSA.

Strategic planning and performance management

51. The municipality did not afford the local community at least 21 days to comment on the final draft of its integrated development plan before the plan was submitted to the council for adoption, as required by Municipal Planning and Performance Management Regulation 15(3).
52. The municipality's performance management system was not in line with the priorities, objectives, indicators and targets contained in its integrated development plan and did not clarify the roles and responsibilities of each role player in the functioning of the system, as required by section 38(a) of the MSA.

Audit committee

53. The audit committee was not functional for the full financial year and as a result did not respond to the council on issues raised by the Auditor-General in the audit report for the

previous financial year, as required by section 166(2)(c) of the MFMA.

54. The audit committee did not review the municipality's performance management system or make recommendations to the council, as required by Municipal Planning and Performance Management Regulation 14(4)(a)(ii).

Internal audit

55. The internal audit unit did not function as required by section 165(2) of the MFMA, in that it did not prepare a risk-based audit plan and an internal audit programme for the financial year under review; it did not report to the audit committee on the implementation of the internal audit plan; and it did not advise the accounting officer or report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, performance management, loss control, and compliance with applicable legislation.
56. The internal audit unit did not report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b) of the MFMA.

Expenditure management

57. The accounting officer did not take reasonable steps to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
58. An adequate management, accounting and information system was not in place to recognise expenditure when it was incurred and to account for creditors and payments made, as required by section 65(2)(b) MFMA.
59. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.

Revenue management

60. An adequate management, accounting and information system was not in place to recognise revenue when it was earned and to account for debtors, as required by section 64(2)(e) of the MFMA.
61. Revenue received was not always reconciled on a weekly basis, as required by section 64(2)(h) of the MFMA.

Asset management

62. An adequate management, accounting and information system that accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
63. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Liability management

64. A management, accounting and information system that adequately accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.

Internal control

65. I considered internal control relevant to my audit of the financial statements, performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the adverse opinion, the findings on the performance report and the findings on compliance with laws and regulations included in this report.

Leadership

66. A large number of control deficiencies in the financial statements, performance report and compliance with laws and regulations, as reported in this report, were identified during the audit and were not identified by management. This indicates that the accounting officer and delegated senior managers have not exercised oversight responsibility in order to support the achievement of clean administrative objectives. In addition, the significant misstatements identified during the audit process indicates a lack of political leadership oversight, thus casting doubt on the credibility of the information political leadership received and subsequently used to make decisions during course of the year.

67. The leadership of the municipality did not provide effective leadership based on a culture of honesty, ethical business practices and good governance, as evidenced by the findings of a forensic report that implicated a number of senior officials at the municipality. There is no evidence that the political and administrative leadership had taken actions subsequently to receipt of the forensic report. In addition, the leadership of the municipality did not promote or enhance the best interest of the municipality, as evidenced by ongoing political infighting that subsequently resulted in the municipal manager being suspended.

Financial and performance management

68. Reliable monthly financial statements and management information of a high quality were not prepared by the municipality. Pertinent information was not identified and captured in a form and time frame to support financial and performance reporting. Numerous errors were noted in the annual financial statements submitted, which is an indication that the financial statements were not adequately reviewed by management before submitting the final version for auditing.

69. The municipality did not have proper record keeping and record management processes to ensure that documentation supporting the amounts and disclosures in the financial statements was properly filed and easily retrievable.

Governance

70. Risk identification and monitoring remain ineffective at the municipality. The effectiveness of the internal audit unit was limited due to a lack of capacity and support from municipal management, resulting in the ineffective monitoring and evaluation of the internal control environment. Due to the lack of an effective methodology and non-adherence to standards on internal auditing, the internal audit work was not undertaken with due professional care.

71. An audit committee was not in place throughout the 2011-12 financial year, therefore limiting the performance of oversight responsibilities. As a result, the committee only authorised the internal audit plan during March 2012 and did not adequately monitor the implementation of internal and external audit recommendations. This resulted in findings being identified during the audit that were either repeat findings from the prior year or findings previously raised by the internal audit unit.

OTHER REPORTS

Investigations

72. A forensic investigation was conducted by an independent consulting firm on request of the municipality. The investigation was initiated based on the fact that a new council and audit committee took office during the year under review. Both the new council and the audit committee wanted a better understanding of what was going on in the municipality and sought the services of an independent consultant. The report highlighted a number of deficiencies and irregularities. In some instances, criminal action was recommended.

Auditor-General.

East London

30 November 2012



Auditing to build public confidence